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Central Intelligence Agency



Washington, D.C. 20505

## DIRECTORATE OF INTELLIGENCE

11 August 1987

Argentina: Seeking Military Coproduction Agreements [redacted]

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## Summary

Tight economic conditions and a pressing need to provide equipment to a disgruntled military establishment are driving Buenos Aires to seek coproduction accords with foreign firms. McDonnell Douglas is considering joint production of A-4 fighters, Brazil has a light transport aircraft initiative underway, Italy is pressing for Argentine participation in the Italo-Brazilian AMX fighter project, and France has various missile deals in the planning stages. Many of these companies hope to defray development costs and are attracted by Argentina's relatively high technical standards and comparatively low manufacturing costs. [redacted]

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Argentine officials [redacted]

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[redacted] strongly prefer joint ventures with US firms, but they are increasingly frustrated by US restrictions on technology transfers in the wake of the Falklands conflict and are pessimistic about any near-term breakthrough. We believe that unless Argentina seals

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This typescript was requested by Mr. Robert Gelbard, Deputy Assistant Secretary of State for South American Affairs. It was prepared by [redacted] South America Division, Office of African and Latin American Analysis. This paper was coordinated with the Directorate of Operations. Comments and queries are welcome and may be directed to the Chief, South America Division, ALA [redacted]

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Copy 15 of 21

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some agreements with US companies over the next year, Buenos Aires will conclude military co-production deals with non-US partners, effectively freezing the United States out of the Argentine defense market. [redacted]

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### Background

When President Alfonsin took office in 1983, he inherited an inefficient and unprofitable military industrial complex. The President moved quickly to repair the defense industries, placing most of the facilities under the control of the civilian-run Ministry of Defense and demanding a comprehensive reevaluation of product lines and export potential. The Ministry concluded that it could restore profitability only through an aggressive export program, and phased out most items produced only for the Argentine armed forces. [redacted]

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Industry studies also revealed that many of the facilities--particularly the aircraft, submarine, and tank factories--were relatively modern and could produce sophisticated new weapon systems. The government's massive defense budget cuts, however, ruled out independent Argentine research efforts to develop new weapons and Buenos Aires turned instead to foreign investors. Argentina first approached the United States, signing a memorandum of understanding with McDonnell Douglas to coproduce the A-4/Skyhawk fighter aircraft and seeking a joint venture with a second US firm for a line of armored vehicles. US Government restrictions on military sales to Buenos Aires, however, excluded most transfers, and by 1985 Argentine government officials began to shift their campaign to Western Europe and neighboring Brazil. [redacted]

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Argentina's most promising negotiations to date, in our view, are for the comanufacture with Brazil of a small transport aircraft and for obtaining a share of Italy's participation in the Italo-Brazilian AMX fighter aircraft. Both involve relatively high technology transfers that would upgrade Argentina's indigenous production capabilities and help re-equip its military forces with minimal hard currency expenditures. [redacted]

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### Brazil

The Brazilian parastatal EMBRAER and the Argentine Aircraft Factory (FMA) at Cordoba agreed last year to develop, produce, and market jointly the Parana light transport aircraft, designated the CBA-123. [redacted]

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[redacted] Under the latest terms of the agreement, completed in early June, both firms will participate in all facets of the program from design through testing and production [redacted]

The CBA-123 project will require a total investment of \$300 million with two thirds from EMBRAER and one third from FMA. Profits from the joint venture's international sales will be split between the partners according to the percentage of investment, but each country is committed to purchase 36 aircraft from the initial run and will keep the entire profits from these domestic sales. [redacted] Brazilian and Argentine teams have already started on the design--a modified version of EMBRAER's successful Brasilia--and expect to test fly the Parana in late 1989 and begin deliveries by 1991. [redacted]

### Italy

After Argentina and Italy signed a defense cooperation pact in 1985, Rome began an aggressive program to encourage Italian public and private firms to invest in Argentina's arms industries. Argentine firms are now negotiating coproduction agreements with a number of Italy's most prestigious defense contractors, and we expect at least some of these ventures to be underway by early 1988. [redacted]

Aeritalia and the Argentine Defense Ministry signed a memorandum of understanding earlier this year to share production of the Italo-Brazilian AMX subsonic fighter aircraft in Argentina, according to US Embassy reporting [redacted]. The memorandum of understanding calls for a \$150 million initial investment by Aeritalia and envisages shared ownership of FMA's aircraft facility by Aeritalia, the government of Argentina, and Argentine private firms. [redacted]

We believe that Buenos Aires finds this deal particularly attractive because it would at least partially privatize the Argentine Aircraft Factory (FMA), one of the biggest financial drains in the defense industrial sector. Several issues, however, complicate eventual AMX coproduction in Argentina. The program already involves three partners--Aeritalia and Aeromacchi of Italy and and EMBRAER of Brazil--and any Argentine share would probably require approval by all parties. The US Embassy in Brasilia reports that EMBRAER is reluctant to reduce its share of the program, and also fears that Argentina might eventually compete for exports in the Americas--Brazil's predetermined AMX marketing area. Moreover, we believe the Brazilian military may

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also be concerned that Buenos Aires--its traditional strategic threat--could end up producing key components of an aircraft that figures prominently in Brazil's hypothetical planning for a future Argentine-Brazilian conflict. [REDACTED]

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The use of the British-made Rolls-Royce Spey engine in the AMX is another barrier to Argentine coproduction, since London would almost certainly veto any sales or production technology transfer to Buenos Aires while the Falklands issue remains unresolved. Aeritalia would have to consider refitting the AMX with an alternative engine if Argentina either produced the complete aircraft or purchased it for its own military. [REDACTED]

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Certain modifications to the AMX program could, however, overcome these obstacles. The Italians, for example, could assuage Brazil's concerns about its percentage by dividing Aeritalia's profit share with Buenos Aires, and by establishing that Argentina's participation would reduce the development funds posted by each partner. Rome could also circumvent UK engine reexport restrictions by limiting Argentina's responsibility to component manufacture or by refitting the aircraft with an alternative engine. Although Italian and Brazilian feasibility studies indicate that this would involve a costly design change, such a move would both enhance the aircraft's attractiveness to Argentina and make it marketable to other countries on Whitehall's blacklist. We believe that China, for example, would be willing to sell its own version of the Spey engine--which Beijing considers an indigenous product not subject to reexport restrictions--for the AMX. [REDACTED]

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We believe that Italy may take some of these steps to further its long-range objective of using coproduction to secure export markets and foreign funds for research and development. Thus, we see a good probability that, in the absence of a US option, Argentina will eventually participate in the AMX--although more likely through component manufacture than as a site for final assembly. Moreover, several other Argentine-Italian technology transfer agreements are currently pending, and although a particular deal may not appear to be advantageous to an individual firm, it may fit into an overall investment strategy adopted by Rome. [REDACTED]

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[REDACTED]

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France

Argentina is also seeking to use the equipment and skilled labor force at its Cordoba facility to build missiles under the provisions of a technology exchange accord with France signed in 1984. [REDACTED]

officials and representatives of the French firm Matra are negotiating the details for licensed production in Argentina of the Mistral surface-to-air missile. The portable anti-aircraft system would be produced primarily for export and Argentina would be free to sell indigenously-manufactured items without approval from Paris. [REDACTED]

[REDACTED] through its sales management agency, Euromissile, recently sent two French representatives to Argentina to research the possibility of selling and eventually producing the Milan anti-tank missile in Argentina. The Argentine military has both of these missile types on its current weapons requirements list and would no doubt welcome the opportunity to upgrade existing stores with such well-established products. [REDACTED]

Miscellaneous Offers

The Argentine Defense Ministry has also received draft proposals from a number of smaller Western producers. [REDACTED] representatives from the Swiss firm, Pilatus, met late last year to discuss coproduction of both the PC-7 turboprop trainer and the PC-9 advanced high-performance version. According to the terms of the draft agreement, FMA would produce airframes and spare parts with guaranteed marketing rights for all components made in Argentina. In addition, Havilland of Canada, a subsidiary of the US firm Boeing, is promoting a project to build a 36-seat commercial aircraft, a stretch version of its DASH-8 model, in Argentina. We believe

[redacted]

that Buenos Aires will consider these proposals carefully, but will be reluctant to commit valuable floorspace and funds to them unless negotiations for more comprehensive cooperation efforts fall through. [redacted]

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### Outlook and Implications for the United States

The financially strapped Argentine government will remain under heavy pressure from a disgruntled military establishment to provide badly needed equipment and increased budget appropriations, but giving in to these demands requires reallocating resources or increasing public sector expenditures. The first is politically unpopular, and the latter leads to higher inflation, jeopardizing Argentina's standing with international creditors. Coproduction will continue to offer the Alfonsin administration a relatively low-cost answer to military needs; jointly produced materiel would cost considerably less than an outright purchase of the same product and export sales would generate badly needed income. [redacted]

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We believe that the Argentines would prefer to work with US firms and would probably opt out of most of the other coproduction talks if Washington gave the go-ahead on US involvement. If the United States does not come through, we believe Buenos Aires will move ahead on coproduction agreements with other countries, placing highest priority on ventures involving maximum indigenous participation, high technology transfers, and rapid implementation schedules. Once Argentina commits its production space to joint ventures with European and Brazilian firms, its limited resources and fairly narrow defense needs are likely to preclude major initiatives with US companies for the next two to five years. [redacted]

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